

Illiquid Credit Search Manager Questions and LACERA Answers

Responses from LACERA (in red) are shown below alongside questions from potential respondents (in blue) to LACERA's Illiquid Credit RFP search. Select questions have been modified for brevity or to anonymize a third party. This document is to be posted on LACERA's website on May 10th, 2019.

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Benchmark:

1. Confirm that LACERA is seeking to use the BBUABI+250bps as its IC benchmark? What is the thought process for selecting BBUABI as the benchmark? Given the IG credit quality and duration of the BBUAB index, there will be significant tracking error based on the proposed asset mix and underlying risk factors. **The Bloomberg Barclays U.S. Aggregate Bond Index + 250bps is the Board-approved benchmark for a sub-category within the asset allocation. There is no pre-specified benchmark for this search. Please identify the benchmark appropriate for your proposed strategy.**
2. Is there an absolute return target for this mandate? **There is no pre-specified return target for this search. Please identify the return target appropriate for your proposed strategy.**
3. Should LACERA's benchmark for Illiquid Credit be considered a proxy for the target return for the mandate? **No.**

Capital Deployment:

4. Does LACERA have a preference for the proposed strategy's capital deployment? Does LACERA have a target timing to complete the ramp up? **We will evaluate the merit of proposals, including the appropriateness of the proposed approach to ramping up the portfolio. Investment pacing preferences would depend on asset category specifics and market dynamics.**
5. RE: Question 72 in RFP -> "Describe the proposed approach to capital deployment for a \$500 million mandate into the proposed investment portfolio and structure..." Would LACERA be open to a "hybrid" approach where the capital is invested into more liquid assets to begin generating return and then rotated into illiquid assets over time? **We will consider this and other approaches to building positions in the portfolio. If a manager views an approach as ideal, it should be proposed and the merits should be discussed.**
6. Is the capital for this proposed allocation coming from cash on hand or divesting from other investments (i.e. will any of capital be from in-kind transfers)? **This mandate would be funded with cash; there would be no in-kind transfers.**
7. Does LACERA intend to allocate the entire \$500 million mandate to a single manager or would it seek to split it up amongst multiple managers? **The purpose of this RFP is to identify an illiquid credit investment manager to implement a significant (up to \$500 million) and foundational allocation for LACERA. We intend to hire a single manager, but will consider other solutions and reserve the right to hire more than one manager.**

Consultant:

8. Will Albourne partake in the evaluation process in any way? **LACERA's Board of Investments approved the hiring of Albourne to perform consulting duties regarding illiquid credit. Contract negotiations and legal discussions are underway. Albourne would participate in the evaluation process after a contract is finalized.**

Diversity and Inclusion:

9. Which portions of Attachment E (Diversity and Inclusion) are considered mandatory and which are considered optional? Please confirm if completing rows 1 (Board of directors/CEO/CFO/COO) and 2 (Investment Professionals) are mandatory. Please confirm that completing row 3 (Compensation %) is optional. **LACERA encourages respondents to be forthcoming with all aspects of our due diligence, including questions pertaining to diversity and inclusion. LACERA takes into consideration the quality and depth of responses as we assess our confidence in a manager's organizational strength, including**

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its ability to effectively access, manage, and retain diverse talent. Section 2, as noted in the RFP, is voluntary.

ESG:

10. Is LACERA looking for a non-ESG, ESG friendly, or ESG dedicated mandate? **LACERA is looking for candidates that are best positioned to deliver attractive returns from less liquid sources of credit risk. As part of LACERA's search, LACERA welcomes information from candidates on the extent to which they have compelling investment processes to identify and integrate material ESG factors that may impact the risk/return profile of the mandate, as specified in the RFP.**

Fees:

11. Does LACERA have a preference for a flat or performance-based fee for this mandate? **LACERA is a fee-conscious investor and evaluates fees in a multi-dimensional and holistic framework. LACERA will consider traditional and custom-tailored fee arrangements and does not have an established preference for this mandate. The degree to which a proposed fee structure promotes an alignment of interest between LACERA and the investment manager will be considered.**

Form 700:

12. Please provide further clarification and examples of who needs to fill out a Form 700 for the proposed mandate. Examples: Principals and owners of the Manager not involved in the investment decisions for the LACERA account; Members of the Manager's Investment Committee who provide guidance and oversight of the Manager's investment activities; Senior Portfolio Managers actively involved in sourcing and executing investment transactions for the LACERA account; 'Back Office' personnel responsible for trade reconciliation and operates related to the LACERA account. **It is up to your firm to determine who must file the Form 700; LACERA cannot make that determination for you. Any and all individuals that have high-level decision making authority and are ultimately responsible for LACERA business must file. Any lower-level employees who may be part of the team that works on LACERA business but do not have ultimate authority to make independent recommendations to LACERA do not have to file.**
13. If manager submits a mandate for an SIF, would it still be required to fill out a Form 700? **The final determination as to whether a manager would be required to file a Form 700 would be based on the specific structure of the SIF proposed.**

Formatting:

14. The IC Questionnaire (Attachment D) provided is in 10pt size font. The RFP instructions state answers should be in 12pt font. Should the manager complete the questionnaire in the original 10pt font? **The answers should be completed in 12-point font.**
15. Can LACERA post the IMA in Word doc form? **Yes.**
16. Can LACERA provide the exhibits referenced in the Investment Management Agreement in template format? (e.g. D&I exhibit in word format) **Yes.**
17. Please confirm the 40-page maximum is limited to just responses and not the questions? **Your response to the questionnaire must not exceed 40 pages. This means that if you use the 13-page Microsoft Word format questionnaire, your responses and the existing questions should not exceed 53 pages.**
18. Are exhibits considered part of the 40-page maximum RFP response? Can they be included separately from the questionnaire? **Exhibits and appendices are not part of the 40 page limit.**

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Exhibits and appendices should only be used where indicated within the RFP questions or the RFP document attachments.

Fund Structure:

19. Will LACERA consider a commingled fund structure instead of an SMA? **LACERA will consider a proposal that is solely in commingled funds. This does not remove the minimum qualification #3 regarding the responding organization managing SMA or fund of one illiquid credit mandates. LACERA will review any proposal that meets the stated minimum qualifications. Please note LACERA's scope of work and preferences as stated in the RFP.**
20. Would LACERA be open to investing via collectives for some of the asset classes or does it strictly adhere to a separate account structure? **LACERA would consider proposals that selectively invest in commingled funds. A SMA and fund of one could invest in a commingled vehicle.**
21. Does LACERA prefer an SMA or Fund-of-One? **LACERA will consider both SMA and fund of one structures and does not have a rigid preference between the two. Preferences are impacted by individual merits and considerations of the mandate being presented.**
22. Will LACERA accept the recommendation from a manager on whether the proposed strategy should be implemented via SMA or Fund of One? **LACERA will consider such a recommendation from an RFP candidate. A proposal should demonstrate reasons behind any such recommendation.**
23. Is this mandate assumed to be evergreen / open-ended in nature? **LACERA is accepting proposals with numerous account structures and is not making this assumption.**

Geography:

24. What is LACERA's preference with respect to geographic diversification/concentration? **LACERA will review any proposal that meets the stated minimum qualifications. Please note LACERA's scope of work and preferences as stated in the RFP.**
25. Examples:
 - a. Will LACERA consider an Asia-dedicated mandate? **Yes.**
 - b. Will LACERA consider a Brazil-dedicated mandate? **Yes.**
 - c. Will LACERA consider a Europe-dedicated mandate? **Yes.**
 - d. To what extent will LACERA seek European exposure over global or U.S. exposure? **This is not determined. We are accepting proposals and open to a manager demonstrating how geographic allocation, or portfolio structure regarding geographic flexibility, should be established.**
 - e. Is there a maximum allocation to non-U.S. investments or any targets for the geographic mix of this portfolio? **No.**

GIPS Compliance:

26. Is GIPS compliance mandatory for this RFP? **No.**
27. Will LACERA accept submissions from managers that are not GIPS-compliant? **Yes.**
28. If selected firm is non-GIPS compliant, will it be required to become GIPS compliant within a set time period post mandate being awarded? **No.**

Legal / Compliance:

29. If a manager proposes a SIF structure, can it submit our own legal documentation? **The manager may submit its own legal documentation for a SIF structure, but the legal documentation would be subject to LACERA's legal review and negotiation.**

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30. Would the proposed agreement be subject to the prohibited transaction restrictions in Section 406(a), 406(b), 408(b)(2) of ERISA? **LACERA is not subject to the prohibited transaction restrictions in ERISA.**

Leverage:

31. Is LACERA open to incurring strategy or portfolio-level leverage? If so, are there any leverage limits we should be mindful of? Are there any parameters around the use of leverage? Does LACERA have a preference for how much leverage is utilized? **Yes, LACERA is open to considering proposals that would or may use leverage. There are no established limits or parameters at this time. Limits may be established in the future and may depend on strategy or portfolio specifics. Proposals that incur the use of leverage will be evaluated on both an unlevered and levered basis.**
32. Are specific assets that use leverage such as traditional repurchase agreements, tranching structures, or total return swaps acceptable in the IC mandate? **Yes.**

Liquidity:

33. Does LACERA have a preference in terms of investor liquidity (notice and redemption terms)? **No.**
34. What is meant by “LACERA would not expect near term liquidity from IC investments”? **LACERA would not favor proposals that focus on liquid credit strategies as mentioned in the RFP document.**
35. Does LACERA need/prefer to receive income distributions from this allocation? Are there preferred income targets? **LACERA does not need or prefer to receive scheduled and frequent income distributions from this mandate. We are open to reviewing proposals that have a range of approaches to potential distributions including during time periods when identifying new investments may be challenging.**
36. Will LACERA consider strategies with a lock-up (e.g., 5-10 years)? **LACERA will consider any proposals that meet the stated minimum qualifications and we will evaluate any lock duration alongside the investment characteristics of the proposed portfolio.**

Multiple Product Submissions:

37. Can a manager submit two options within its proposal (e.g. portfolios with different asset class concentrations / diversification targets)? **Yes, so long as the response does not exceed the 40-page response limit or the 3-page executive summary limit.**
38. How should a manager submit performance for a blend of two strategies as a proposed portfolio? Would it be appropriate to create a blended return series that is representative of the weights of each in our proposed portfolio along with a return series for each of the separate strategies? **Performance blends should be clearly identified with respective sub-strategy weights across time periods. Yes, performance for each individual sub-strategy should also be shown.**

Minimum Qualifications:

39. Does LACERA consider the MQs to be at the firm-level (investment management firm) or specific to the underlying investment strategy for submission? **The MQs are at a firm level. MQs #2, #3, and #4, are firm level and also apply to illiquid credit mandates.**
40. How strict are the IC MQs? If a firm has all of the criteria with the exception of one item, will LACERA exercise discretion? Examples:
- Current (proposed) strategy does not have a U.S. public pension. **This would not meet MQs.**

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- b. Current (proposed) strategy does not have a U.S. public pension plan but has a corporate pension plan. **This would not meet MQs.**
 - c. Current (proposed) strategy does not have a U.S. public pension plan but has a non-U.S. public pension plan. **This would not meet MQs.**
 - d. Current (proposed) strategy does not have a U.S. public pension plan but the firm has U.S. public pension plan clients in other strategies. **This would not meet MQs.**
 - e. Manager does not have a track record as described exactly in the RFP. **This may meet MQs, additional information is required.**
 - f. Manager “can show a combination of long (5yrs +) and short (<5yrs) individual strategy track records that we can use to support our proposal”. **This may meet MQs, if the proposed strategy has an adequate allocation to components that have at least a 5-year track record. The evaluation team will consider if the proposed strategy is similar in scope to strategies that have a 5-year track record.**
 - g. Manager’s track record with outside investors is less than five years long but is longer than five years if it includes its parent company, a U.S. insurance company. **This may meet MQs, additional information is required.**
 - h. Manager is in the process of closing on a U.S. pension plan. Would LACERA consider a soft-circle sufficient? **This would not meet MQs.**
 - i. Can manager include capital commitments for a very near term credit fundraise in order to meet the \$5 billion illiquid credit AUM requirement? **This would not meet MQs.**
 - j. Can a manager use total firm assets, rather than strategy assets, as part of its AUM requirements? Is there flexibility if IC AUM is less than \$5 billion. **Firm-level assets in illiquid credit strategies that are not part of the proposed portfolio would qualify as meeting the minimum qualification so long as the firm, in aggregate, manages at least \$5 billion in illiquid credit strategies. Firms that do not manage in aggregate \$5 billion or more across one or multiple illiquid credit strategies will not meet the stated minimum qualifications.**
 - k. The minimum qualification list states that the organization must have at least \$5bn of assets under management in illiquid credit mandates. Is this a hard requirement or can you be flexible if our firm falls below the \$5bn? **Meeting all of the MQs is required and the \$5 billion number is not flexible.**
41. Does the 5-year track record apply to the individual components of the strategy or in combination (i.e. does the manager need to demonstrate 5 years of track record for the exact same cross-credit SMA)? Given that this will be bespoke, a track record of a combined strategy would be difficult to provide. **This may meet MQs, if the proposed strategy has an adequate allocation to components that have at least a 5-year track record. The evaluation team will consider if the proposed strategy is similar in scope to strategies that have a 5-year track record. We understand that some market segments are newer and a 5-year track record may not exist, for example, for niche types of asset backed securities. It would be sufficient to have a 5-year track record for similar types of investments. It may also be acceptable if there is a 5-year track record for a majority of the target sub-strategies, but not for select niche sub-strategies that, in aggregate, are a minority of the proposed mandate.**

NDA / Confidentiality:

42. Will LACERA enter into a separate non-disclosure agreement (NDA) with the investment manager to ensure confidentiality of the information being provided? **If this question refers to the RFP responses in general, no we will not enter into an NDA. If the RFP response contains confidential information,**

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the RFP instructs respondents to mark sections confidential and to cite the PRA exemption. Should a PRA request be submitted we will evaluate confidential marks for redactions.

43. To what extent does LACERA consider a manager's information 'Proprietary' under the California Public Records Act? **None of the RFP response is confidential unless it is marked confidential along with a code citation as to PRA exemption.**

Placement Agent / Third Party Marketing:

44. Does Attachment G (placement agent disclosure) need to be completed at this stage of the RFP process? **LACERA is requesting that all managers complete the placement agent disclosure form as part of the RFP process.**
45. Who does LACERA consider to be a placement agent? Would LACERA consider a member of a manager's internal investor relations team to be a placement agent? **Please refer to Section 7513.8 of the California Government Code. An internal employee of a manager may be considered a placement agent.**
46. Does question 23 (list third party representatives) apply to potential representatives working on the LACERA mandate or should it include all representatives engaged by the firm in general? **Question 23 applies to third party representatives used by the firm and is not isolated to just third party representatives who may interface with LACERA representatives.**

Restrictions:

47. Does LACERA have any specific restrictions to the IC mandate? Examples: investments, concentration, investment grade quality, risk? **There are no established restrictions and we are open to reviewing a proposed mandate structure or portfolio guidelines.**

Return Objectives:

48. What is LACERA's total return target for the IC mandate? In absolute and relative basis, if applicable? Short-term and over a full market cycle, if applicable? Does LACERA have a preference on the risk/return profile of the proposed IC mandate? **There is no established return target and LACERA is open to reviewing proposals across a wide range of return expectations.**
49. Should this mandate be considered to be yield oriented or opportunistic? **Please note LACERA's scope of work and preferences as stated in the RFP document.**

Strategy:

50. Provide further context to LACERA's question: Does your approach have a "base," "neutral," or "normal" allocation across any sub-strategies or market segments? Questions 67 of the RFP can be restated in the following manner: **If the proposed portfolio would allocate across numerous sub-strategies or market segments, is there a target allocation or an allocation range? Explain.**
51. Will LACERA consider niche strategies (agriculture focused IC)? **Yes.**

SEC Registration:

52. Will LACERA consider managers that are exempt from SEC registration, but not due to their status as a bank or insurance company? Example: Ex-U.S. manager has less than \$150 million in U.S. AUM and does not need to register with the SEC. **Yes, upon confirmation of appropriate SEC registration exemption**

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Timing:

53. Does a manager need to submit a redacted version of their materials by 5/24? Is there flexibility to submit redacted materials later? **A redacted version is required before a response can be reviewed.**
54. What is the approximate timing between Board approval of the investment manager selected to funding of the IC mandate? **1-4 months depending on contractual and legal matters.**

Track Record Related:

55. Executive summary, item 7: if the proposed strategies are implemented through drawdown mandates, should the manager provide IRRs and vintage years, rather than calendar year performance? **This is acceptable.**

Types of Investments:

56. Will LACERA consider (liquid/illiquid) fund investments as part of a broader mandate (in lieu of/combination with direct investments)? **Yes.**
57. How does LACERA consider allocations to large / illiquid investments? Would LACERA prefer a portfolio composed of 4 – 5 positions in commercial mortgages that often have min check sizes of \$50 million or would LACERA prefer to make these types of investments via a commingled fund with the same fee structure as an SMA for diversification purposes? **Please note LACERA’s scope of work and preferences as stated in the RFP document.**
58. Will distressed credit ever be a component of the Illiquid Credit asset class at LACERA or will that exposure come from another asset class at LACERA? **Distressed credit may be a component of the chosen mandate from this search. We would like managers to make proposals based on their competency and views on ideal portfolio structure.**
59. Will LACERA consider portfolios that invest in deep-value and “stressed” single name bonds and loans that are prone to periods of liquidity interruption? **Yes.**
60. Do all investments need to be denominated in USD? If not, does LACERA have a preference for a currency hedged portfolio/strategy? **No. We do not have a preference and we would consider whether to hedge currency risk alongside additional information.**
61. Does LACERA have a preference for positioning within the capital structure? (i.e. senior secured focused or flexible to move up/down capital structure?) **LACERA does not have a preference for the position within the capital structure.**
62. Will LACERA contemplate a proposal that includes exposure to credit derivatives including synthetic credit default swaps of individual corporate issuers and the relative corporate credit indices? **Yes.**
63. Would LACERA consider ownership in a separate asset-heavy business (e.g. aviation) as a specialty finance / asset backed lending? **Yes.**
64. Would LACERA consider investments in instruments that have a residual claim to a portfolio’s principal and interest (after liabilities have been paid) but they do not have a contractual set of cashflows or contractual yield (such as CLO equity)? **Yes.**
65. Is LACERA open to CLO equity and debt being a part of this mandate? **Yes.**
66. Can CLO equity be considered as part of Corporate Structured Credit? **Yes.**
 - a. In both the primary and secondary markets? **Yes.**